# DOW THEORY LETTERS INC.

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Mar. 27, DJIA 770.26; PTI 280; A-D ratio -28.65
Apr. 4, DJIA 747.26; PTI 259; A-D ratio -29.61

"If a pickpocket meets a saint, he sees only his pockets." Hari Dass Baba.

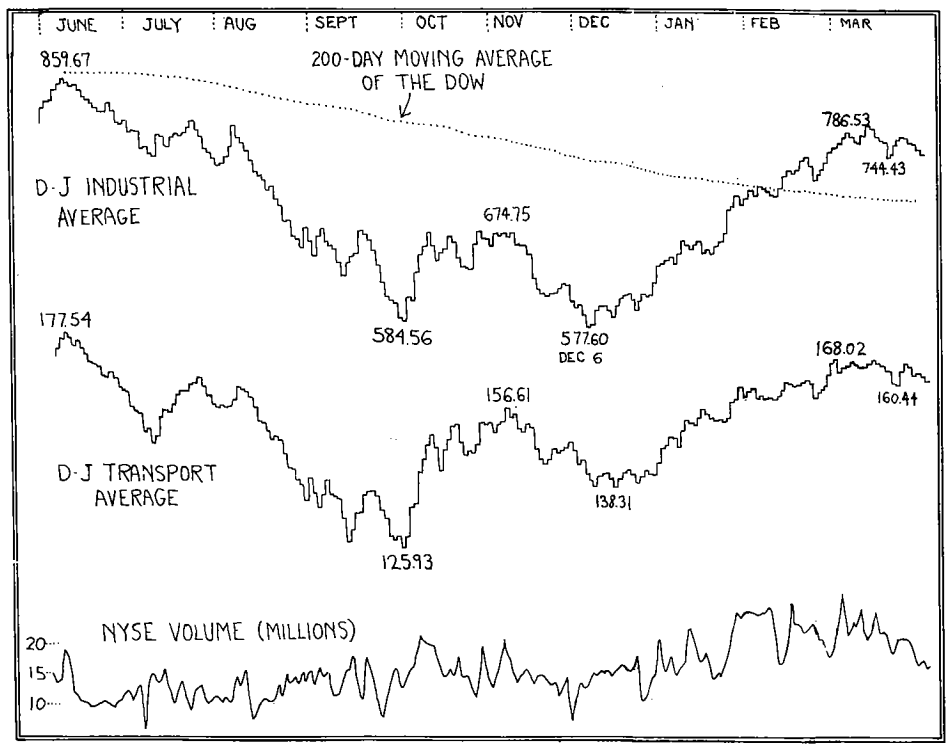
THE PICTURE: What the great Indian sage (quoted above) is saying is that you can be blinded by your own wishes and desires. Very few men study the market coldly, open-mindedly, unemotionally, then take a position based on their studies. The usual process is to read the newspapers, talk to the local guru, buy stocks, and then hope the market performs according to their wishes. Unfortunately, Wall Street seldom obliges. In other words, you better align yourself with the prevailing market trend; the market couldn't care less whether you become as rich as Midas or run the family fortune into a shoestring.

In the last report I presented a case for a primary bull market based on the price structure following an eight year bear market (i.e., 1966 to 1974). I noted that if I was wrong, if we have simply been witnessing an upward explosion in a continuing primary bear market, then in due time the Industrial Average will break its 577.60 low of December 6, 1974, and the Transports will confirm by dropping below the 138.31 low of December 16, then the 1974 low of 125.93 (Oct. 3) and perhaps even below the 1970 low of 116.69.

I don't think we're going to see that kind of downside action. Of course, anything is possible, but I just don't think we're going to see it. I felt that the lows of 1974 discounted the worst that could be seen ahead, and that from December on, it was the bulls' turn to run the market (at least long enough to produce something that would go down in the history books as a primary bull market).

In view of my bull market stance, why did I suggest "no more buying" in Letters 624 and 625? And why did I suggest "moving to the sidelines" in Letter 626? If you're looking for a scientific answer to that one, there is none. But here is some of the reasoning that went into that decision: (1) The first psychological phase of the bull market ended with the termination of the "buying stampede" (see last Letter). The tremendously strong technical situation brought on by the downside compression of 1974 had, to a large extent, unwound by mid-March, 1975. With the end of the bull market's first phase, I felt that Wall Street would take a sterner look a reality. Remember, economic fundamentals do not change overnight, even though the tide of the market has turned.

Every primary swing (bull or bear) tends to over-run itself, and I felt that the buying stampede had created a bit of euphoria. Now the problems (particularly in the bond market) are beginning to surface again. I don't think the long list of troubles are going to take the Averages to new lows (in other words, I believe this is a primary bull market). But Wall Street can turn from rosy optimism to sleepless nights in the space of 24 hours. I wanted my subscribers to avoid the rude awakening that might follow the December-to-March buying stampede.




(2) By mid-March the unweighted market averages had advanced around 42% from their 1974 lows. The Dow had advanced 36% from its own 1974 low. The market had become heavily over-bought. The technical situation had turned less certain than at any time since December. It seemed like a good

 time to stop, look, listen, and to do it all from the sidelines.

(3) By March everybody was talking about a correction, but many rather sophisticated advisories were taking a contrary opinion on this. I thought the stage might be set for a fooler, the fooler being that what "everybody was expecting" just might occur (taking a contrary stance on contrary opinion!).

(4) The consensus of those expecting a correction was that such a correction would be "mild." I felt that this actually allowed for the possibility of a severe correction, of the 50% or more variety.

(5) I reasoned that if a correction did get started, and a spate of bad news then developed, many analysts would very quickly start doubting the bull market thesis and begin wondering if we were not actually in a continuing bear market. Thus, a mild correction could easily turn into a scary decline, perhaps even a panic (in reality, of course, the panic decline would be a correction of the panic advance or buying stampede of December-March). Note: Of 54 advisory services monitored by Bob Gross's Professional Investor, 50 now believe it's a bull market. With most of these advisorys now long-term bullish and with their subscribers loaded with stocks, a good correction here could set up a lot of doubts and a load of shock waves.

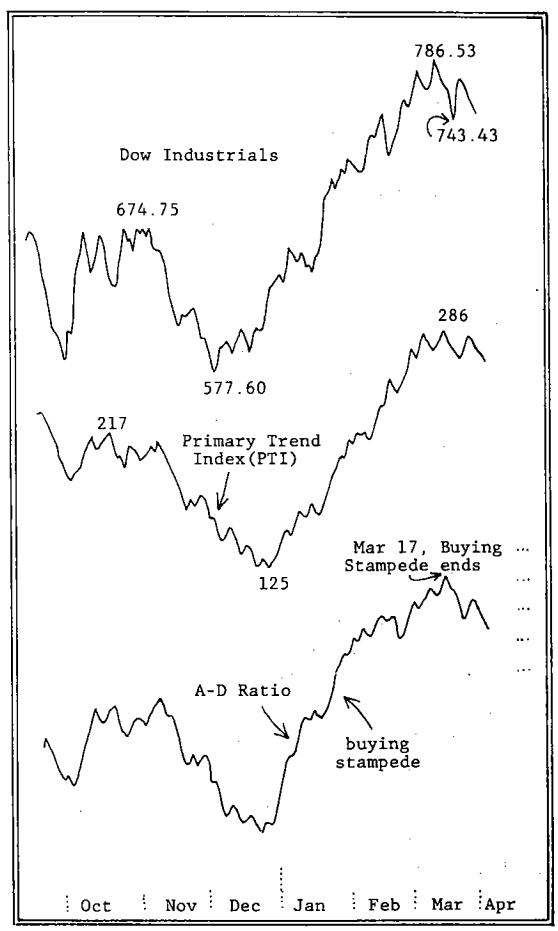
(6) Bull markets usually provide at least two outstanding "buy spots" each year. We have already utilized one such buy spot, that of December-January. Most of my subscribers garnered large profits during the December to March rise. I felt that we were entitled (following such a phenomenal rise) to move to the sidelines and await another buy spot, even if such a spot did not arrive until summer or fall.

(7) It bothered me that market sentiment changed from almost total bearishness last December to almost total acceptance of the "new primary bull market" thesis in March. I felt that investors should be more worried about the actual primary trend. A reaction would serve to raise doubts about the bull market.

(8) Finally, the great majority of advisors were suggesting "adding to purchases" on any reaction. My instinct told me that selling on rallies might work out better (with the mental stipulation on my part that we would get back into the market following a potential severe decline, a decline rough enough to thoroughly scare and confuse the Johnny-come-lately bulls).

As to the odds of a severe correction, it might help to put the situation in perspective if we realize that the 151.9 point first quarter advance in the Dow was the largest quarterly pointage rise in history. The 24.6% first quarter rise in the Dow was also the largest first quarter percentage rise in stock market history. Explosive rises tend to breed severe corrections. An important secondary correction now should hardly come as a surprise.

NEAR-TERM: From the Dow Theory standpoint, we have some fairly helpful guideposts to watch at this time. Referring to the page 1 chart, note the 743.43 Industrial low of March 24. Note also the 160.44 Transport low of March 25. As long as one or both Averages manage to hold above these points, I will classify the secondary trend of the market as bullish. However, a downside penetration of those levels by both Averages will definitely turn the secondary trend of the market bearish. In that case, I would say that Wall Street should ready itself for its first important downside test of 1975.




Referring to the daily chart of the PTI and the Advance-Decline Ratio, note that the A-D has now traced out a downward zig-zag pattern. This was formed when the April 3rd closing broke below the March low. Whenever this occurs following an important advance, I feel that the market has presented itself with a very difficult technical problem. The ultimate resolution of this problem is almost always lower prices. The die, technically speaking, has been cast.

There are two potential resolutions to the picture on the chart. (1) Industrials could break below their March low of 743.43, thus confirming the bearish indications of the A-D Ratio. In that case, the Industrials and the A-D would at least be "in gear" (on the downside), and we could have a further decline. If this "plan" is followed by the market, I do not think the decline would be too severe. In other words, technically I would prefer that the market follow this course.

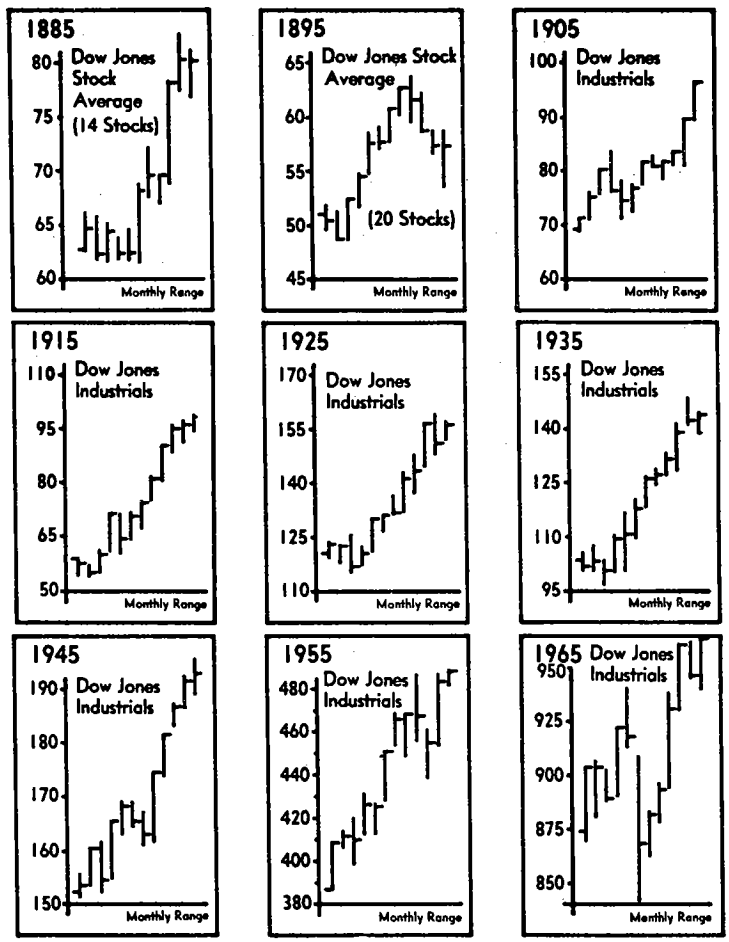
(2) The other possibility would be a new advance by Industrials taking the senior Average to a new 1975 high (above the 786.53 peak of March 17). If this happens, the A-D is almost surely not going to confirm (I know this from experience with these formations). Consequently, we would have an important non-confirmation, and the stage would then be set for a probable major and teeth-rattling descent to lower levels. In either case, I believe we would be seeing no worse than a secondary correction (of undetermined duration and extent) within a continuing bull market.

On April 4 my Primary Trend Index (an amalgam of eight critical market gauges) followed the lead of the A-D Ratio, tracing out a downward zig-zag below its March low. Thus the market (in its incredible unconscious wisdom) has presented us with a technical story that was clearly there for all of us who would take the trouble to read it. First, in December, amid universal gloom and despair, the market said "Buy," and buy we did. What followed was one of the great investment stampedes of modern history. In March, following sixty days of almost steadily rising prices, the market said, "Wait," and we did that, despite gathering optimism on the part of Wall Street and Washington. In the last Letter I wrote that the signals were telling me that the clouds were forming, and it might be best to get on the sidelines with raised umbrellas. I trust my subscribers have listened and acted.

The latest words from Wall Street are "technical problems," and those technical problems are going to have to be resolved. The longer the downside action is held off, the more time for distribution, and the greater the "build-up" for the coming reaction. A subscriber called today and said, "I know you said 'Sell,' but should I sell stocks where I have losses as well as the ones where I have profits?" I answered him the only way I know how, "When I say sell, neither I nor Wall Street gives a damn whether you've got 90% gains or 90% losses. The powers above may want to bail you out of whatever troubles you have, but Wall Street couldn't care less. Sell means sell, and buy means buy. You take it from there."

Another subscriber called to tell me that he "can't" sell now because his profits aren't long-term yet. I told him that he may be choosing the wise path, but he can't prove it by me. All too often, those who hold stocks (with built-in paper profits) through a good reaction end up with no tax problems at all. The market takes care of that in short order, but I guess in the end each of us, like the Biblical Jacob, has to wrestle with our own demons.

HAPPY CYCLES: True cycle theories entail periodicity or time periods. Thus Dow's Theory and the Elliott Wave Principle are not actual cycle theories. Both deal with form — not time. A Dow Theory bull market can take a few years to a few decades. An Elliott Wave form can consume a day or a thirty-year period. But a true cycle has to do with a time period, such as every six months, every year or every decade. When a true cycle materializes, it occurs on time regardless of news events, an Act of God, psychology or anything else.

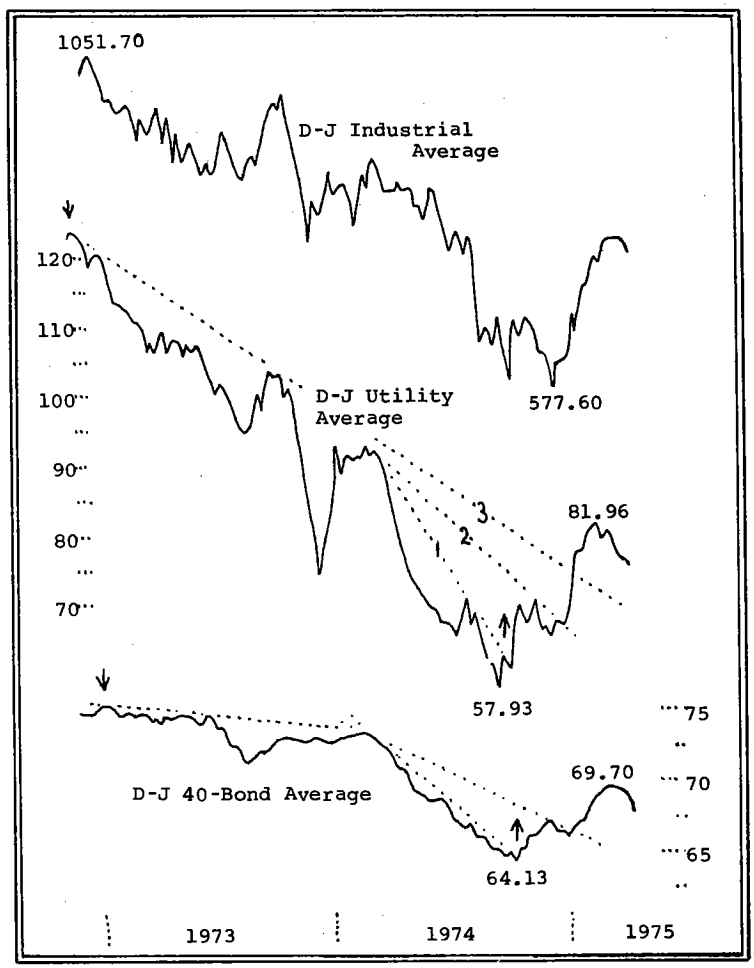



One of the famous cycle theories was put forth by Tony Gaubis and Edgar Lawrence Smith. It is called the "Decennial Pattern," and it has to do with the repetition of cyclical forces during each successive decade. Thus, when the Dow pattern for each decade was placed over the pattern for the preceding decade, it was seen that the same forces exerted themselves. For instance, the seventh year of each decade tends to be the worst of the decade and the tenth year was next to worst. On the other hand, the fifth year tended to be the best year of the decade while the eighth year was second best.

Since we are now in the fifth (and presumably best) year of the current decade, this study in probabilities takes on extra significance. I include this most interesting chart study which shows the monthly range of the Dow for each fifth year since 1895 (courtesy of M/G Financial Weekly). First, note that during each fifth year the Dow closed that particular year higher than it opened. Nevertheless, 7 of the 9 years did contain corrections, each of which produced two or more months of consecutive decline. Only one year ended on a severe correctionary note, and that was 1895. Based on this cyclical study, I would say that 1975 "should" end with the Dow substantially higher than it was on January 1, and that we should have at least one good correction in which the Dow will close lower for two consecutive months.

Here is another interesting technical observation having nothing to do with cycles, but I want to include it. The Dow was up (on a closing basis) during each month of the first quarter of 1975. This has occured twelve times since 1897. Only once (in 1930) following a "three months up" first quarter has the Dow failed to post a plus for the year. Again, the figures suggest that the year 1975 should be a net "up year," but as seen in the pattern of the year 1895 and again in 1965 a net up year for the Dow does not guarantee a picnic for investors.

CRUCIAL: The story of 1975 may be told on this chart. As veteran readers know, I use the two money-sensitive Averages, the D-J Utilities and the D-J 40-Bonds as gauges of the monetary background of the market. Any time both the Utility and the 40-Bond Averages are in established downtrends, I consider the monetary background for common stocks to be negative. On the other hand, a rising trend in the Utility and Bond Averages is considered as a monetary green light for Wall Street.




As seen on the chart, the trend of the Utility and Bond Averages was down all through 1973 and most of 1974. This literally greased the runway for one of the worst market collapses in Wall Street annals. On September 13, 1974 the D-J Utility Average slid to a stop at the incredible value of 57.93, lowest level in twenty years. Three weeks later, on October 3, the 40-Bond Average halted its sickening decline at 64.13, lowest point in the history of the 40-Bond Average (going back to 1915). Despite talk of a cave-in of the monetary system of the West, despite rumors of a 15% Treasury bill rate, the money Averages stopped going down!

Beginning October 4, the Utilities and Bonds headed up together. On December 6 the still-declining Dow Industrials his bottom at 577.60. By late December the entire market was following the lead of the money-oriented Averages.

On February 21 the Utility Average struck a 1975 high of 81.96. On March 10 the 40-Bond Average hit its 1975 high of 69.70. From there the two Averages have backed off. The question, of course, is whether the Utilities and Bonds are merely correcting, or whether they are in major trouble. The source of the potential trouble appears to be well-advertised. An increasing mountain of debts and deficits with corporations and everyone else coming into the money market for new money. It's a picture which, the pessimists say, will send the money markets reeling and interest rates climbing through the roof.

Maybe so, maybe not, but I'll take my cue from the market, not the optimistic economic experts or the pessimists from "Doom City." What I'm watching now is T-Bill rates (which are starting to rise a bit), Treasury Bonds (which are declining after a major advance), and the two Averages on the chart (which are probably correcting).

All right, how do I know that they are "just correcting" rather than topping out for the duration? Well, obviously I don't have THE ANSWER, but again I feel that a good deal of what's ahead is now known. And the two money-oriented Averages are still well off their '74 lows. Also, referring to the Utility Average, I have drawn three fan-lines (numbered 1 through 3). Usually, the penetration of the third fan-line signifies an important reversal of the trend that produced the fan-lines (in this case, the downward trend.).

At any rate, it will be most important to watch the progress of the Utility and Bond Averages over coming weeks and months. Personally, I don't think they are going to new lows. But if the monetary collapse that we are promised is about to materialize, then new lows on these two Averages would be literally assured. If so, there's no question about it — it would be time to run (not walk) to the nearest exit.

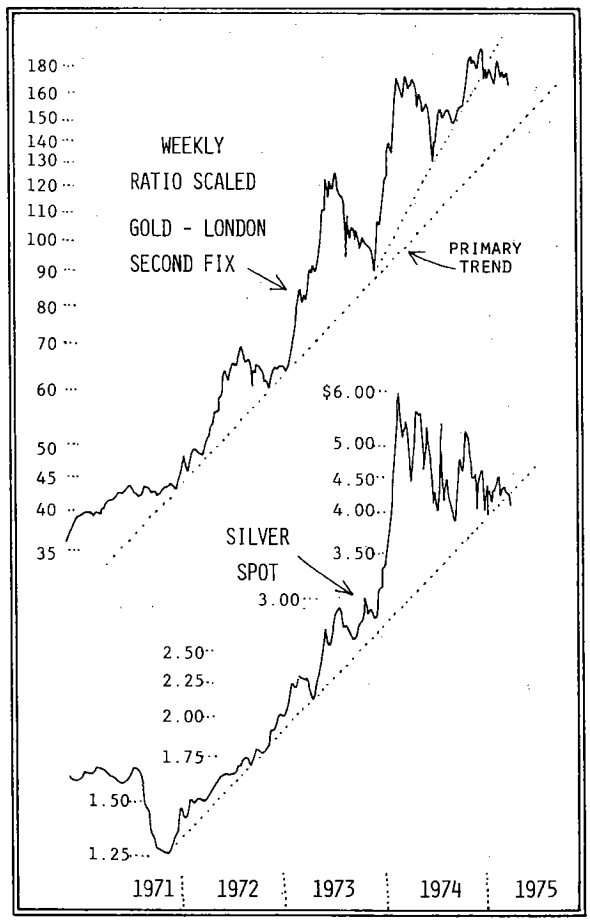
DOW AND INFLATION: Last week a subscriber wrote to complain about my statement that the "Dow Jones Averages adjust for everything including inflation." This gentlemen continues, "I don't know anyone who claims that somehow the Dow adjusts itself for inflation. Way back in 1963, nearly 12 years ago, the Dow was about at the level of today. During that time (I am looking at the chart), the cost of living has risen about 75%. Now if I put $100,000 in the Dow in 1963, I can get the same $100,000 back today, but I would need $175,000 for the same purchasing power. Yet you say that inflation has been adjusted for! Dow 750 in 1975 just ain't the same as Dow 750 in 1963, no way!" T.O., Santa Barbara, CA.

Answer: Ah yes, this is what happens when a student becomes too single-minded. My friend from Santa Barbara is under the illusion that the only thing the Dow adjusts for in inflation. Why, because he happens to be thinking about inflation. But inflation is simply one of the items to which the Dow adjusts. Today, right now, the Dow is adjusting for inflation plus the oil situation, Israel and the Arabs, Mr. Ford, the fall in commodities, the low level of liquidity, the US deficits, the new fees on Wall Street, sun spots, tide levels, crop reports, speculative sentiment, the odds for war with China or Russia, the price of coffee in Brazil, EVERYTHING, and I mean every variable known to man. The Dow is adjusted not simply for inflation but what the market thinks about inflation and what the market thinks regarding the effects of inflation on stock prices.

Frankly, I don't know whether the market thinks inflation is going to recede, and I don't know whether the market thinks potential inflation is bullish or bearish. For that matter, the market could now be discounting stability over the foreseeable future. Or the current low level of P/E ratios on the Dow (now about 7.5) could be reflecting deflation. But I'll bet on one thing. Whatever is coming up on the inflation-deflation-stability front, it's now being factored into the Averages (along with thousands of other things) with more accuracy than any man, group of men or computers could ever achieve.

All right, then why is the Dow at the same price it was 12 years ago following 12 years of inflation? Because despite the inflation, the market thinks there are enough adverse factors around today to make the Dow (despite inflation) worth no more than it was in 1963. As a final thought, I submit that at this point the market may well believe that the 12 years of inflation since 1963 was a detriment to stock values. Never forget this, the market deals with VALUES, and inflation is just one of the variables built into the gauge of values.

GOLD, SILVER: Many newer readers probably wonder why I write about gold in almost every report. One reason is that gold is the true money, and the price of gold acts as a barometer of the health of paper "money." A second reason is because a very large number of the nation's dyed-in-the-wool gold boosters read these reports, and they seem to want to know what I think about gold. A third reason is because gold and gold shares can be investments, they can be speculations, they can be a crucial part of one's investment portfolio, and they can also be a decided detriment when you're holding them during a primary bear market in precious metals. I think we are in a bear market in gold and silver now. I've thought so for quite some time. I might add that many gold detractors also read these reports, hoping that I'll say something "bad" about gold and silver. If that's your position, forget it. I say little more than the market itself tells me, and right now I don't think it's telling me a happy story for precious metals.




The fundamentals for South African shares are not particularly bright at this juncture. The S. African work force is now 25% below needed strength. Mine owners have tripled wages over the past three years, and all my information suggests that more boosts are coming. Neighboring Rhodesia is going to get black rule; it's only a matter of a year or a few years. S. Africa is trying to enter into "detente" with its black neighbors, but the tide in Africa is now moving relentlessly towards majority rule, and that means pressure on the whites. And the tide is moving fast. Furthermore, Arab money will probably back black political desires as will Chinese technical and fighting know-how. All this will mean that S. Africa must strive to keep its black population "happy." And one way they will move to do it is with black wage levels moving towards the white man's wage levels. If you think differently, you're kidding yourself. This isn't 1962, when we first started buying the gold shares, and it isn't 1968, when events were moving slower. It's 1975, and Asia is tottering and the Arabs have a lot of dollars, and the US has carloads of arms to sell to anyone who can buy them. And the US has a big, voting black population, so the pressure, in my opinion, is finally on — in earnest.

"But all this could be bullish for gold," you retort. "Lower gold production, a fiasco at the mines, that could be 'gangbusters' for the price of gold." It could be, indeed, if the underlying primary trend of gold bullion was bullish. But I don't think it is. I warned about gold in the last few reports. Now the charts are starting to talk.

Last week, gold closed in London under my intermediate trendline (see chart in the last Letter), and gold is now about to test the 170 level. My point & figure chart shows gold in a huge topping formation with a major bearish signal in effect if either the first or second London fixing touches 169.

On the accompanying weekly chart we see that gold has ruptured its secondary trendline. Its major or primary trendline comes in at 145, and if 169 is broken, it could be that gold is fated to test the primary trendline.

But even more dramatic (see chart) was last week's break by spot NY silver below its primary trendline, a trendline that has held since 1971. I have stated before that a silver breakdown would be one of my signals for a coming deflation. Since silver is a big industrial metal, I feel that the critical break in silver is saying deflation for prices in general, and a let-down in industrial usage for silver and other materials.

As for the stocks, silver stocks have already come downhard. With the cost squeeze on, with the price of labor going up, with Canada going increasingly socialist, with Africa going into increasingly

4/5/75
DAR ES SALAAM, Tanzania (UPI) — Black African and Arab leaders will meet here tomorrow to map the political future of southern Africa for the next decade.

At issue is a choice of peace through detente with white-ruled Rhodesia and South Africa or widespread guerrilla war.

Each of the black African and Arab countries represented here is agreed on the overall objective — black majority rule in Rhodesia and South Africa as quickly as possible.

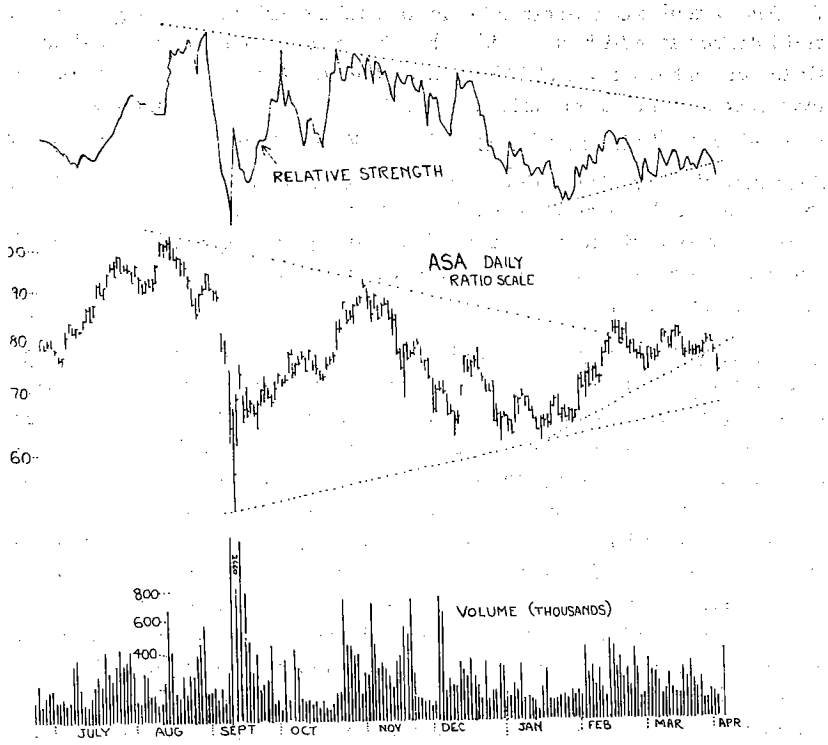
**SEEK JOINT PLAN**

The conference must weld a joint African plan to reach this goal.

The special session of foreign ministers was called by the 42-nation Organization of African Unity (OAU) to frame a response to South Africa's "detente offensive," which Prime Minister John Vorster began last autumn.

The Rev. Ndabaing Sithole, a black nationalist leader, was freed from detention in Salisbury, Rhodesia yesterday and joined an African National Council delegation headed for the conference.

troubled times, the gold shares have, I feel, been under distribution. They may be going into the final move of their bear market (which started in August, 1974, and this may be the move that will see them discount the worst that lies ahead.




Refer to my daily ratio chart of bellwether ASA, the leading closed-end fund that has almost all of its assets in S. African gold mining shares. Note that ASA formed a top at 104 in August, 1974, then crashed to a low of 52. The automatic "post-panic" recovery in ASA took the stock to a November high of 93. Then ASA did something I never like to see. It turned down hard on big volume under its previous peak high. By January, 1975 ASA had hit a low of 62. A third rally took ASA to February value of 84. At the time I said, "Let's watch and see if ASA can break out of its big triangle on volume." It did not, and I didn't like that action either. Most recently, the third ASA peak has developed into three smaller descending peaks with volume indications very poor for ASA (each rally brought in less volume). Finally, on Friday, April 4, ASA (with most of the other gold shares) "gapped" down, breaking to its lowest price since early February.

Note that the relative strength line on ASA gave little encouragement to the gold bulls. RS in ASA is now not far from the crash low level registered last year. From this point, I would watch the lower trendline on the chart of ASA. A price of 65 would serve to break that trendline decisively, in which case I would say that the technical structure of ASA had completely broken down. I would prefer my subscribers not be in on this coming "test," and for this reason I have turned increasingly negative on gold. What I have said for ASA pertains to all gold shares. We may buy 'em in a few months or a few years, but I do not want them now.

One of the big foolers at this time could be the increasing effects of deflation, not inflation. In the latest Bank Credit Analyst for April, Editor Tony Boeckh states, "The basic conclusion that derives from our work is that the forces of deflation will continue to exert great pressures for a lengthy time. These pressures have been underrated for over a year now and are still underrated. Few even appear to be aware of the extent to which price inflation has abaged already and this abatement will continue...."

Boeckh believes that ultimately inflation will break out again, and it will break out big. I agree, but gold now seems to be dealing with deflation, the pressing need for cash, rising gold mining costs and political troubles in general. Following the current gold decline, the golds could be ready to deal with rampant inflation which may appear say in 1976 and 1977. But as I have said before, "Let's work on one primary trend at a time."

LATE NOTES: (April 7) The market opened up on the weak side with Industrials plunging below the 743.43 March low during the first hour. A close below 743.43 with a confirming close by Transports below their 160.44 level (see page 1 chart) will mean that the secondary correction is underway. Low volume in the early stages of a decline is not a bullish indication (as so many seem to believe), it merely means that very few people are getting out as the market heads lower.

DOCTOR SMOCK
By GEORGE LEMONT
ATTENTION, PLEASE! OUR HOSPITAL GIFT SHOP IS NOW GIVING AWAY FREE GOLD BARS AND NUGGETS WITH EVERY PURCHASE OVER FIVE DOLLARS!
I KNEW THE STUFF WASN'T MOVING WELL, BUT THAT'S RIDICULOUS!
4-7

I assume that subscribers tend to act on what I write in these reports. If that is true, then based on the last Letter you should be out of your stocks and out very near the highs with good profits. Such action on your part means that you can watch the development of the correction with academic interest, rather than with the proverbial white knuckles gripping the edge of the chair.

I feel that most of the "good news" for the first half of 1975 is now out. At Dow 786, the market had fully discounted it. Now we are backing off to absorb the bad news. A 50% correction of the 209 points from Dow 577 (Dec.) to 786 (Mar.) would mean 682 for the Dow. It could happen. Once a bull market secondary gets under way, it usually does not stop short of fear or even panic selling. That's how this decline could end, but it will take time. If you've been waiting for a good spot to take your vacation, you're there.

The psychology of the times is oft reflected in the cartoonist's pen. The public's disappointment with gold is seen in this cartoon from my morning paper (see above). A year or so from now, when inflation is again exploding, we will probably find this cartoonist presenting a far different and more bullish gold story! Meanwhile we are going to see a bit of deflation.